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THE DIRECTOR OF CENTRAL INTELLIGENCE

WASHINGTON, D.C. 20505

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3 December 1982

National Intelligence Council

MEMORANDUM FOR: Director of Central Intelligence
Deputy Director of Central Intelligence

THROUGH: Chairman, National Intelligence Council
Deputy Director for Intelligence

FROM:
National Intelligence Officer for Economics

SUBJECT: CIA Policy Support on East-West Economic Relations

1. For your information. This memorandum reviews the state of play on the follow-up to the "non-paper," discusses the main issues, and shows how the DDI and the NIC could contribute to the process. It has been coordinated with the Directors of SOVA, EURA, OGI, OSWR's Technology Transfer Assessment Center, and within the NIC.

2. The SIG-IEP has been given the task of organizing the follow up to the tentative Allied agreement on Secretary Shultz' "non-paper" concerning development of a coordinated policy on economic relations with the USSR. Separate interagency groups will be established for each of the four principal areas of concern. Another will deal with East-West economic relations in general (see attached chart). The joint studies and other consultations with our Allies on these areas are expected to yield some sort of agreement that would be announced at the planned Economic Summit in May.

3. The four areas scheduled for joint study with our Allies are:

- (1) European alternatives to Soviet gas--to head off construction of any additional Soviet gas pipelines to Western Europe.
- (2) Strengthening COCOM.
- (3) Considering other possible controls on exports of advanced technology to the USSR.
- (4) Restricting officially backed credits to the USSR and subsidized interest rates.

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Criteria for Allied Policy

4. The central agreement in the "non-paper" is to examine East-West economic policy in the context of alliance security. Economic warfare is rejected on the grounds that economic interchange brings economic benefits for both sides and can have a stabilizing impact on political relations. There is also agreement that East-West economic relations need to be adjusted to the advantage of the West by:

- o Minimizing the enhancement of Soviet military capabilities.
- o Minimizing subsidies (e.g., on interest rates).
- o Avoiding excessive Western economic dependence on the USSR (e.g., on gas imports).

Finally, there is agreement on the need for a differentiated approach to East European countries.

Possible Questions and the CIA Role

5. Each of the IGs will do detailed tasking. CIA will be involved in this process. In addition to responding to specific requests, CIA has a major contribution to make in helping to clarify thinking on the broader picture, as well as on each of the major issues.

General Questions

6. The US and its Allies will have to try to gain as much agreement as possible on the following kinds of general questions:

- o How and to what extent does the USSR use economic relations with the West to expand its military power? Portions, perhaps expanded, of recent SNIEs on East-West issues could be used to prepare a discussion paper.
- o How and to what extent can Western economic actions influence Soviet domestic and foreign policies in both the short run and the longer run? Several CIA and NIC papers dealing with aspects of this problem have been written. A SOVA paper on the implications of the Soviet economic slowdown, including the role of economic relations with the West, is planned for the first quarter. It may be appropriate to draw together the main points of these studies in a summary paper.
- o How is Eastern Europe likely to be affected by the policy interactions of the West and the USSR? How limited are its own options to deal with its economic problems, given Western and/or Soviet actions? The NIE which is in progress on the

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implications of the East European economic problems should cast light on this issue.

- o How can expanded East-West trade increase Western vulnerability to Soviet actions? This issue has been discussed in various studies dealing with the Yamal pipeline. Some further work may be in order.

Alternative Energy Sources

7. This US initiative is in excellent shape with regard to the preparation of joint studies, but in poor shape with regard to specific planning for concrete actions. CIA/OGI has done a great deal of excellent work on the international gas market and on energy markets in general, in support of the US effort to head off the construction of new Soviet gas pipelines. An international study of the European gas market and security is underway in the IEA, and CIA has excellent substantive links to that organization. The broader OECD energy study, promised in the Shultz "non-paper," will presumably build on the IEA study and be done by largely the same people. OGI will prepare a parallel study on West European dependence on energy imports and a similar one on Japan. A detailed OGI analysis of the West European gas grid and its connections with the Soviet gas system also is planned; this study will be dependent on IEA data, but will push the analysis further.

8. The difficult part will be to determine exactly what are the specific technical, legal, administrative, and political factors which determine Norwegian gas policies, and how these factors mesh. Until we have a great deal more specific information on these questions, it will be impossible to determine specifically what we would like the Norwegians to do, which possible steps might conceivably be acceptable to the Norwegians, what kinds of complementary actions would need to be taken by other countries, and perhaps what sweeteners might have to be provided. There is little chance of completing such a study before the next Economic Summit, but perhaps a start can be made. This will require a rather intensive consultation and collection effort and possibly use of a well-connected external contractor.

9. A related issue on which CIA can be of help is the Soviet energy problem and how it impinges on Western interests. OGI and SOVA expect to have completed their major study of Soviet oil production prospects early next this year. In the meantime, SOVA has been working on production of Soviet gas and other energy sources, and is in a position to do improved analysis of Soviet energy consumption and substitution possibilities. This work should make it possible by the end of March to prepare an integrated paper on Soviet energy prospects and policies, which would include an assessment of oil and gas export possibilities and Soviet dependence on Western equipment and technology. It would probably be desirable for the study to become a National Intelligence Estimate, although that will take

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longer. To be useful in our discussions with our Allies, the paper should be declassifiable to about the Confidential level.

Controls on Exports of Military-Related Projects and Technology

10. Work on this topic will occur mainly in the COCOM framework. CIA's contribution is likely to be on specific products and technologies, and enforcement-related issues on clandestine and illegal deliveries to the Soviet Bloc. The SNIE, "Allied Attitudes Toward Export Controls" is generally still valid. It could be updated with a brief memorandum.

Transfers of Other (Non-COCOM) Advanced Technologies

11. The Allied agreement to study this issue is extremely vague and does not appear to involve any clear commitment. The US had been pushing for some Allied controls over exports of oil and gas equipment and technology to the USSR as a possible specific quid pro quo for dropping the pipeline sanctions. The Allies apparently refused to consider such steps, but agreed to discuss oil and gas equipment and technology as part of a more general review of non-COCOM technology transfer issues. The agreement on the "non-paper" does not appear to provide any conceptual basis for singling out oil and gas equipment and technology from any other Western exports to the USSR, except to the extent that they can be shown to have important specific military uses. CIA has done a great deal of analysis concerning Soviet dependence on Western oil and gas equipment and technology, much of which can be shown to our Allies. But as an argument for controls, these estimates are likely to fall on deaf ears.

12. A broader joint examination of the impact of transfers of high technology on the USSR could cover such issues as how Moscow uses its position as a monopoly buyer operating in a competitive market and the possible magnitude of its economic gains from high technology imports. Such questions have been examined before, however, without yielding much in the way of useful results. Moreover, it would be extremely difficult to obtain Allied agreement on a policy involving export restrictions based on the criteria of the size of Soviet economic gains, because this would smack of economic warfare.

13. The chances of agreement with our Allies are far greater if technology transfer is evaluated in terms of its impact on Soviet military capability. Imports of advanced technology, both embodied and disembodied, are important to the development of Soviet industries, the products of which are used to an important extent to increase Soviet military capabilities. In turn, increased Soviet military capabilities force Western countries to raise their military expenditures in order to compete.

14. Allied studies of how imports of Western technology enhance Soviet military potential could be used to lay the foundations for improvements in COCOM controls. COCOM itself is too narrowly focused and

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does not have sufficient military representation to cover the issue adequately. A great deal of analysis of the import requirements of Soviet weapons systems, especially future systems, could profitably be done in NATO or other fora so long as there was agreement to use this analysis as an input into COCOM. Off-the-shelf and newly developed US intelligence analyses would be critical; an Intelligence Community effort would be needed.

Controls Over Credits and Interest Rates

15. This topic was explored quite thoroughly during the Buckley initiative prior to the Paris Economic Summit. SOVA is in the process of updating its earlier paper on Soviet hard currency and debt prospects. That paper was shown to and discussed with the Europeans and Japanese and the new one could serve the same purpose. EURA is in the process of updating its estimates of East European debt, and will prepare a preliminary assessment of the West European financial state in relations with CEMA countries.

16. A close examination of how the Soviets handle Western credits and debt in their own economic and financial accounts could be very useful. Recent reporting suggests that they give preference to borrowing at low (German Mark) rates rather than at high (French franc) interest rates because of the rigidities of their own domestic incentive and accounting procedures. If this is the case, efforts to reduce interest subsidies by pressuring the French are likely to be ineffective. It would be better to find another way.

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